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In The Supreme Court of the United States

MCLANE WESTERN, INC.,

Petitioner,

v.

DEPARTMENT OF REVENUE, STATE OF COLORADO, *ET AL.*,

Respondents.

On Petition For Writ Of Certiorari To The Colorado Court Of Appeals Division IV

BRIEF OF THE COLORADO ASSOCIATION OF DISTRIBUTORS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

INTEREST OF *AMICUS CURIAE* 1

SUMMARY OF THE ARGUMENT 2

ARGUMENT 3

I. THE COLORADO TAXING SCHEME BROADLY DISCRIMINATES AGAINST DISTRIBUTORS THAT ACQUIRE OTHER TOBACCO PRODUCTS FROM OUT-OF-STATE CHANNELS 3

II. THE COLORADO TAXING SCHEME PRECLUDES GEOGRAPHICALLY-NEUTRAL DECISION-MAKING AND INVITES IRRATIONAL BEHAVIOR 5

III. VALIDATION OF THE COLORADO METHODOLOGY HAS BROAD RAMIFICATIONS FOR OTHER EXCISE TAXES 6

CONCLUSION 7

TABLE OF AUTHORITIES

Page

STATUTES

Colo. Rev. Stat.
§ 39-28.5-101 3
§ 39-28.5-102 ..... 3, 4
§ 39-28.5-102.5 4

RULES

Sup. Ct. R. 37.6 1

INTEREST OF *AMICUS CURIAE*

This *amicus curiae* brief in support of the brief of Petitioner is submitted pursuant to Rule 37 of the Supreme Court Rules.[1] Counsel for Petitioner and Respondents have consented to the filing of this brief. Their consent letters have been filed with the Clerk of the Court.

The Colorado Association of Distributors ("the Association") is a federation of eight companies[2] engaged in the distribution and wholesale sale of cigarettes and other tobacco products, confections, snacks, health and beauty care products, and assorted other items. The Association works to protect and promote the interests of its members in dealings with manufacturers, distributors, retailers, and the public at large.

All of the Association's members, like Petitioner, purchase tobacco products other than cigarettes from distributors located outside Colorado. As a consequence, Association members acquire tobacco products following sales (and associated price mark-ups) that take place wholly outside Colorado. Because the base for the subject levy is the price paid by the distributor that first brings or ships the tobacco products into the state, Association members either pay directly to the State of Colorado or find embedded within their purchase price a higher tax

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus curiae* state that no counsel for any party authored this brief in whole or in part and that no entity other than *amicus curiae* made a monetary contribution to the preparation or submission of this brief.

[2] The eight companies are: Bradford Distributing, Cash-Wa Distributing, Cigarette Store Corporation, Core-Mark International, Creager Mercantile, McLane Western, Inc., Smoker Friendly International, and S.R. Flaks Company.

than they would pay were the tobacco products manufactured or first distributed within Colorado. Thus, *amicus curiae* and its members are directly impacted by the levy's discrimination against interstate commerce.

SUMMARY OF THE ARGUMENT

Amicus curiae makes three points in this brief. First, the Colorado tax on tobacco products other than cigarettes produces genuine economic harm for distributors, such as the Association's members, that choose to do business with out-of-state entities. Because the ultimate Colorado tax base rises with each sale taking place outside the state, Colorado distributors face a higher tax burden (and therefore, inevitably, higher product prices) the later in the stream of commerce the tobacco products enter the state. These higher prices both reduce demand for the product and place distributors that acquire product through out-of-state channels at a competitive disadvantage versus those distributors that elect or are able to acquire product that enters Colorado earlier in the stream of commerce.

Second, these effective penalties upon participation in the interstate market for goods have a coercive effect on economic decision-making. The Colorado scheme pressures Colorado distributors to prefer and to seek Colorado sources for acquiring tobacco products. At the same time, it pressures out-of-state manufacturers and distributors to relocate operations into Colorado (so as to satisfy Colorado distributors' interest in minimizing the tax base). These pressures are real, and they are material.

Third, the principles raised by this matter are far-reaching. If the Colorado levy on tobacco products is allowed to stand, virtually any excise tax on virtually any product could be molded to prefer in-state activities at the expense of out-of-state activities.

ARGUMENT

I. THE COLORADO TAXING SCHEME BROADLY DISCRIMINATES AGAINST DISTRIBUTORS THAT ACQUIRE OTHER TOBACCO PRODUCTS FROM OUT-OF-STATE CHANNELS

As a factual matter, it cannot reasonably be disputed that the Colorado scheme imposes a higher levy on tobacco products first marketed and distributed through out-of-state channels than it imposes on products immediately marketed and distributed within Colorado. By setting the tax base as the prevailing product price upon the occurrence of the first of various enumerated events that takes place "in this state," the Colorado statute ensures that commerce conducted outside the state will suffer a heavier burden than commerce conducted within the state. *See* Colo. Rev. Stat. § 39-28.5-102 (identifying events that trigger the levy); *see also id.*, § 39-28.5-101(3) (defining "manufacturer's list price").

Petitioner has presented effectively the legal authorities that mark this scheme constitutionally infirm (*see* Petition for Writ of Certiorari ("Petition"), pp. 9-19), and accordingly, *amicus curiae* does not repeat that discussion here. Instead, *amicus curiae* wishes to highlight the very significant and widely-felt impact of the present discrimination. *Any* Colorado distributor that relies upon out-of-state

channels to acquire tobacco products will face a higher levy on the products than it would face if it relied on in-state channels.

The nature of the tobacco products industry is such that virtually all manufacturing activity takes place outside Colorado. Moreover, product often passes from the manufacturer through one or more distributors before reaching Colorado. Indeed, most of the Association's members purchase tobacco products following out-of-state sales. Because each out-of-state sale has the effect of inflating the ultimate tax base, virtually all tobacco products that reach the state will experience a heightened levy based solely on the locus of earlier commercial activity outside the state. Given that the tax is now imposed at a rate of 40% of the product price upon entry into Colorado (*see* Colo. Rev. Stat. §§ 39-28.5-102, 39-28.5-102.5), virtually any increase in the tax base will generate a material increase in the tax due.

These higher levies have direct consequences for Colorado distributors of tobacco products. They necessarily translate into either higher downstream prices (and a consequent reduction in sales) or lower product margins, or a combination of both. At the same time, the disparate burden on non-Colorado commerce leaves many Colorado distributors, including the members of *amicus curiae*, at risk of competition from other distributors whose only advantage is an ability to acquire tobacco products that enters the state earlier in the stream of commerce.[3]

[3] *Amicus curiae* notes that these same pressures and competitive threats may be felt by retailers that acquire tobacco products following predominantly non-Colorado commerce.

Amicus curiae believes that industry participants should not be penalized due to decisions to conduct business with entities operating outside Colorado.

II. THE COLORADO TAXING SCHEME PRECLUDES GEOGRAPHICALLY-NEUTRAL DECISION-MAKING AND INVITES IRRATIONAL BEHAVIOR

If allowed to stand, all Colorado distributors that rely on out-of-state distribution channels (including all of *amicus curiae*) will be heavily incented to pursue new product sources that are able to bring the product to Colorado earlier in the stream of commerce. For example, in-state, upstream distributors will be preferred over out-of-state, upstream distributors. Conversely, entities now operating entirely outside Colorado will need to consider relocating operations into Colorado in order to meet customers' demand for a lower levy, and hence, a lower product price.

While the behavior induced by this scheme may reduce the levy itself, it is otherwise economically irrational. Consider a first-level distributor ("D1") that currently purchases tobacco products from a manufacturer entirely outside Colorado, but then re-sells that same product, at a marked-up price, to a second-tier distributor ("D2") operating in Colorado. Under Colorado's current scheme, the marked-up price paid in the second sale will set the base for the levy, as it is this second sale that causes the product to enter the state. As a result, D1 now has a choice. D1 may continue business as usual, leaving D2 to pay tax on a higher base. Or, D1 may establish a warehouse in Colorado and have the manufacturer ship all product D1 intends to sell to D2 to the Colorado warehouse.

Choosing this latter option (*i.e.*, routing the product to Colorado prior to the sale to D2) will reduce the tax base from the price D2 pays D1 to the price D1 pays the manufacturer, thus reducing the ultimate product cost to D2. Yet, in chasing this lower tax base, D1 has established a warehouse in Colorado that serves no other economic purpose. To the contrary, it very likely creates substantial additional burdens. Now consider how these burdens would be magnified if every state established its tax base in the same manner as Colorado.

III. VALIDATION OF THE COLORADO METHODOLOGY HAS BROAD RAMIFICATIONS FOR OTHER EXCISE TAXES

Colorado might have chosen any number of alternative methodologies for determining its tax base that would not have discriminated against interstate commerce. Colorado could have measured the tax base by the price charged to the ultimate consumer, as, for example, a traditional sales tax. The state could have measured the tax base by the units of product sold, as, for example, per-gallon excise taxes on fuel. Or, Colorado could have measured the tax base by the weight of the product sold, as, for example, per-ounce excise taxes on tobacco products. Each of these other methodologies, in contrast to Colorado's, makes no distinction regarding where events in the stream of commerce take place, and accordingly, each raises no constitutional concern.

Validation of Colorado's scheme by the Court would expose an array of other excise taxes to a similar preference for in-state activities. For example, if the Colorado levy on tobacco products were allowed to stand, Colorado (or any other state) could modify its sales tax to measure

the tax base for the sale of any item of tangible personal property by the price paid upon the first sale by a manufacturer or distributor within the state. In this manner, virtually every product sold would face differential taxes depending on the level of commercial activities that took place with respect to that product within or without the taxing state. The widget manufactured and first distributed outside Colorado would face a higher tax than the widget manufactured and first distributed within Colorado. Again, the result would be to coerce in-state operations (*e.g.*, manufacturing and distribution) at the expense of out-of-state activities. Such discrimination against interstate commerce does violence to our national market for goods, and *amicus curiae* urges the Court to declare it unconstitutional.

CONCLUSION

For the foregoing reasons, and those set forth in the brief of Petitioner, the Court should grant the Petition and reverse the Colorado Court of Appeals.

Respectfully submitted,

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